Furniture Brands
INTERNATIONAL

Broyhill

Lane

Thomasville

1997 ANNUAL REPORT

Financial Highlights

(In thousands, except per share, employee and statistical data)	*Year Ended December 31,* 1997	1996	1995
From continuing operations:			
Net sales	$1,808,276	$1,696,795	$1,073,889
Net earnings[1]	67,053	54,222	29,463
As a percentage of net sales	3.7%	3.2%	2.7%
Net earnings – as adjusted[2]	79,742	66,919	41,933
As a percentage of net sales	4.4%	3.9%	3.9%
Per share of common stock (diluted):			
Net earnings[1]	$ 1.15	$ 0.88	$ 0.58
Net earnings – as adjusted[2]	$ 1.36	$ 1.08	$ 0.83
Financial condition at year end[3]:			
Working capital	$ 482,288	$ 462,661	$ 455,036
Current ratio	4.5 to 1	4.2 to 1	4.4 to 1
Total assets	1,257,236	1,269,204	1,291,739
Total long-term debt	667,800	572,600	723,679
Shareholders' equity	$ 323,322	$ 419,657	$ 301,156
Average common shares (diluted)	58,473	61,946	50,639
Number of employees	20,700	20,800	20,700

[1] Net earnings before extraordinary item, net of taxes, and before gain on insurance settlement, net of taxes.

[2] Adjusted to remove depreciation and amortization related to fair value adjustments, net of taxes.

[3] 1995 balances reflect the acquisition of Thomasville Furniture Industries, Inc. on December 29, 1995.

Contents

Letter to Our Shareholders

Furniture Brands International continued its industry-leading performance — both financial and operational — during 1997. Net sales were $1,808.3 million versus $1,696.8 million reported in 1996, an increase of almost $112 million or 6.6%. This sales performance clearly maintained the Company's position as the largest residential furniture manufacturer in the United States. Net earnings were $67.1 million in 1997 compared to $54.2 million (before an extraordinary item relating to early extinguishment of debt) in the prior year — an increase of 23.7%. Net earnings per common share, on a diluted basis and before the 1996 extraordinary item, rose 30.7% in 1997 to $1.15 versus $0.88 last year. The sales, net earnings and net earnings per common share for 1997 represented a record performance for the second consecutive year (including eight consecutive quarters of record results).

As noted in past years, the Company's financial results are negatively impacted by charges for depreciation and amortization resulting from the 1992 asset revaluation (i.e., fresh-start accounting). Excluding these depreciation and amortization charges, diluted net earnings per common share would have been $1.36 and $1.08 for 1997 and 1996, respectively (before the 1996 extraordinary item).

The Company's 1997 financial performance represents a continued strong endorsement of the effectiveness of its strategic plan — a plan that is aggressive and is still in process of being fully implemented. This plan consists of four primary growth strategies:

- Strengthen operating management,
- Grow market share profitably,
- Improve operating profit margins and
- Expand operating company coordination.

Organizational Changes

During 1997, and continuing into 1998, organizational changes have been made throughout the operating companies to strengthen the overall management team and to deal with succession requirements. The most notable of these changes was the appointment of Christian J. Pfaff to President and Chief Executive Officer of Thomasville effective the beginning of 1998. Chris, who transferred to Thomasville early in 1997 from the Company's Broyhill subsidiary, is an example of the management strength within the Company, and its ability to move talented managers among the operating companies to provide experience and leadership opportunities.

The Company's mission statement is "To become the residential furniture industry's undisputed leader as an innovative furniture manufacturer and in the process to deliver a significantly improved shareholder value." The management and employees of the Company are focused on achieving this mission.

Market Share Growth

The Company is committed to grow market share profitably by: driving its brand names — Broyhill, Lane and Thomasville — through creative advertising and marketing programs; expanding dedicated and nondedicated distribution by increasing dealer-owned stores, galleries and furniture centers, which feature our products exclusively, and by entering into strategic alliances with major retailers to gain added floor space; and introducing new and innovative products supported by professional consumer research to ensure customer and consumer needs are met. Included in this annual report are numerous examples of the product, marketing and distribution programs developed by the Company to grow market share.

Margin Improvement

Operating profit margin improvement continues to be a key growth strategy of the Company. Our objective is to accelerate cost reduction initiatives across all operating companies. Annual cost reduction targets are set based upon specific percentages of each operating company's cost of sales, and these targets are monitored closely to assess progress. Management is involved in a highly-focused effort to improve the utilization of our manufacturing asset base. To achieve the capacity utilization goals of the Company, it was necessary during 1997 to close a Thomasville case goods manufacturing plant and to transfer a Lane wood veneer facility to another location. Conversely, because of increasing demand for its new and existing products, the Action division of Lane was granted approval in early 1998 to expand the capacity of one of its plants by 300,000 square feet. Finally, a constant review of low profit margin products is performed to ensure product lines meet profitability requirements.

Company Coordination

Expansion of operating company coordination has received renewed emphasis during the last year with the formation of various committees of operating company management to capitalize on the potential synergies that are available when three large companies in the same industry are united. These committees are addressing such important areas as: cross manufacturing; recalling out-sourced production; volume purchasing; complementary sales and marketing efforts; and joint international sourcing. Of particular importance is ensuring "best practices" are employed in all operating functions of each company.

Equity Transactions

Several important transactions were completed during 1997 which affected the Company's capital structure and significantly improved shareholder value. In June, the Company completed a comprehensive plan for the exit of its largest shareholder. A secondary offering of 11 million shares of the Company's common stock was completed on behalf of Apollo Investment Fund, L.P. and Lion Advisors, L.P. At the same time, the Company purchased from this same shareholder approximately 11 million shares of common stock and warrants to purchase common stock. To finance the share and warrant purchase, which approximated $170 million, the Company entered into a non-amortizing, 10-year senior bank facility. This transaction allowed the Company to purchase its common stock at an attractive (discount) price while broadly distributing the remaining Apollo and Lion shares among current and newly enrolled shareholders in the public market. In August, the Company called for redemption of all its Series 1 Warrants (approximately 1.3 million). As a result, the Company received approximately $9.3 million from the subsequent exercise of the warrants. This transaction completed the disposition and/or redemption of all previously existing series of warrants.

Operating Cash Flow

Operating cash flow was very favorable during 1997 due to the strong earnings performance and good working capital management. Internally generated cash flow was used to fund a substantial capital expenditures program totaling approximately $40 million. The Company remains dedicated to being a low-cost producer by investing in new manufacturing technologies, while maintaining existing facilities in peak condition. At the same time, the Company is committed to an aggressive deleveraging program. During 1997, $80 million in long-term debt repayments were made, $70 million of which occurred in the last half of the year subsequent to the common stock purchase noted earlier. This deleveraging activity, which is expected to continue in the future at a similar rate, when coupled with the Company's current debt facilities, provides a flexible capital structure to fund future growth opportunities.

Investor Relations

Over the last several years, the Company has implemented an aggressive investor relations program to communicate its operational and financial successes to the public. Presentations at investor conferences and equity roadshows, as well as increased analyst and investor contact with corporate management, has heightened awareness of the Company as a major branded consumer products manufacturer, and broadened its support among the investment community.

New Board Members

As a result of the exit of Apollo/Lion as the Company's largest shareholder, the Board of Directors was reconfigured during 1997 to include four new directors: Katherine Button Bell, Michael S. Gross, Brent B. Kincaid and Albert E. Suter. These individuals bring a wide array of experience and skills to the Board. The backgrounds of the four new directors range from detailed knowledge of the furniture industry to broad experience in manufacturing, finance and marketing in a variety of industries as well as extensive corporate management responsibility. Unfortunately, due to the demands of other business commitments, Mr. Gross has chosen not to stand for reelection to the Board. His thoughtful counsel will be missed.

Company Outlook

The Company's momentum entering into 1998 is excellent. Retailer response to our product offerings, marketing and distribution programs continues to be very favorable. Incoming orders during the fourth quarter of 1997 were significantly higher than the prior year, and the Company's order backlog at December 31, 1997 was $223.2 million, representing an 8.7% increase over the previous year. In addition, the overall economic fundamentals (e.g., consumer confidence, housing activity, employment, income levels, interest rates, etc.) continue to be positive.

Today, Furniture Brands International is the largest and most profitable residential furniture manufacturer in the country. The Company's mission statement is to become the residential furniture industry's undisputed leader as an innovative furniture manufacturer and in the process to deliver a significantly improved shareholder value. The Company believes it has achieved the former and continues to work hard to produce the latter. The management and employees of the Company are focused on achieving this mission and look forward with enthusiasm to working with our suppliers, customers and consumers, as well as the investment community, in this endeavor.

On behalf of the management and employee team, I thank you for the confidence you have shown in the Company. We continue to recognize our responsibility to increase shareholder value and look forward to the challenges and opportunities in 1998.

Sincerely,

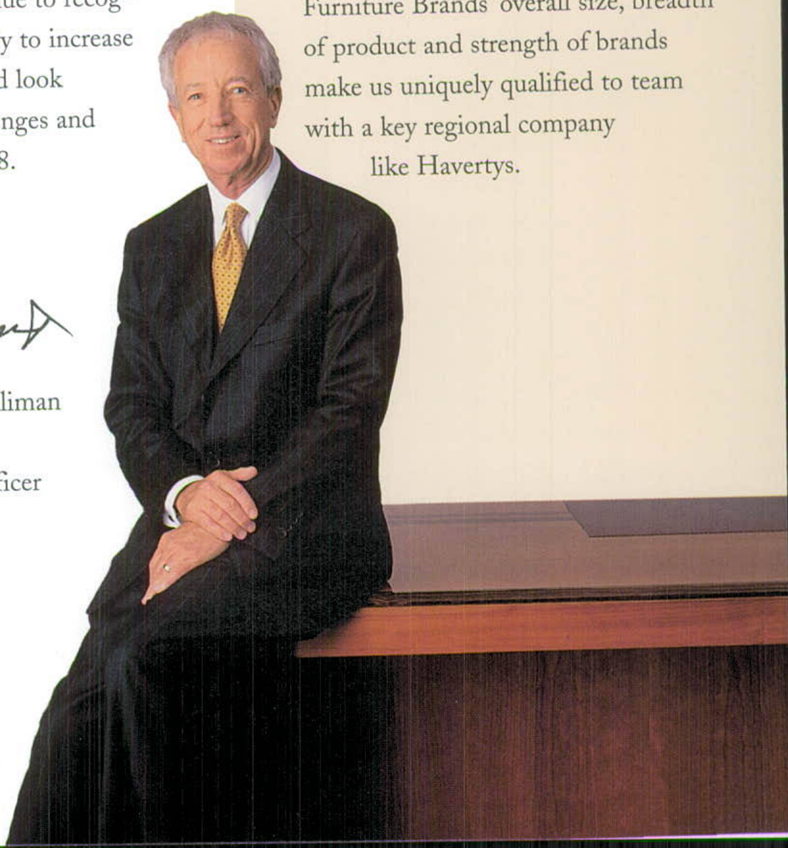
W.G. (Mickey) Holliman
President and
Chief Executive Officer

Strategic Alliance

On February 10, 1998, the Company and Haverty Furniture Companies, Inc. jointly announced a strategic alliance under which Havertys will allocate up to 50 percent of its retail floor space to furniture manufactured by our operating companies. In turn, Furniture Brands International will increase our service support to each of Havertys five regional distribution centers.

Havertys is the nation's fifth-largest furniture retailer with 97 showrooms in 13 states. This alliance, the first of its kind in the furniture business, underscores the Company's position as an innovative leader in our industry and advances our strategy of expanding distribution and dedicated display space.

The program begins in the second quarter of this year, and we expect it to be fully implemented by mid-1999. Havertys already carries Broyhill, Lane and Thomasville products, but this alliance will significantly increase our presence in Havertys stores. Furniture Brands' overall size, breadth of product and strength of brands make us uniquely qualified to team with a key regional company like Havertys.



Furniture Brands International markets

an extensive range of high-quality

products

that cover a broad price spectrum.

Furniture Brands International is the largest and most profitable residential furniture manufacturer in the United States. We offer a broad range of products that focus on the good, better and best price categories, which provides higher growth opportunities and profit margins.

This strategy puts us in the right place at the right time, as today's consumers are increasingly buying higher-priced, higher-quality furniture due to its long-term value.

We already are well positioned on selection, quality and value within each of the major residential furniture style categories, including American Traditional/Country, 18th Century, European Traditional and Casual Contemporary.

Our manufacturing leadership continues to be strengthened by extending our already broad product lines in the more profitable price categories.

We are becoming increasingly innovative in our new product development process. New products, such as Lane's new ComfortKing recliners and Flexback chairs have been enormously successful. These product innovations come through internal discussions, ideas from full-time company designers and feedback from retailers about what consumers are telling them are important product features.

Now, we are beginning to add an important new dimension to the process as we employ consumer research in new product development. We believe this research will make new product introductions even more successful, as well as further differentiating us from the rest of the industry.

Our goal is simple — To become the industry leader in producing high-quality, innovative residential furniture products. The following section provides specific information about products at our Broyhill, Lane and Thomasville operating companies.

BROYHILL FURNITURE INDUSTRIES, INC.

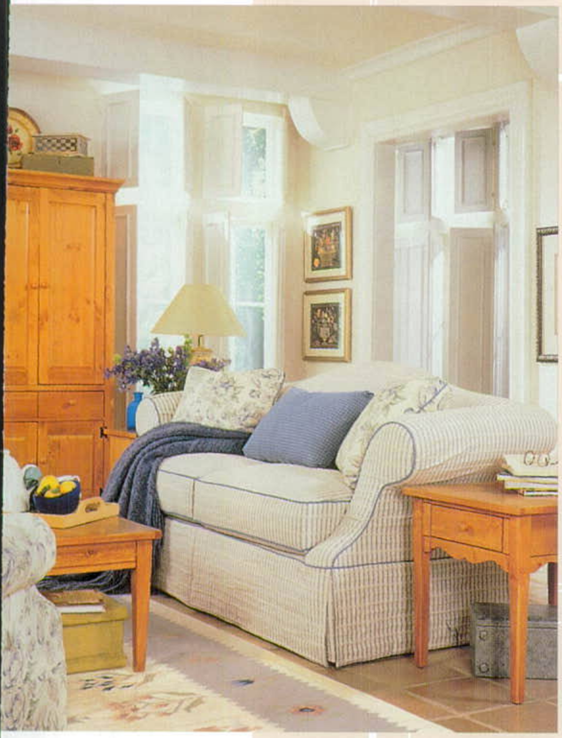
Broyhill has become one of the most widely recognized residential furniture brands in America since its founding more than 70 years ago. Though the industry does not publish sales volume figures, we believe that Broyhill's Fontana collection has been the best selling furniture collection for the last three years.

The company manufactures a full line of wood furniture, upholstered products and occasional pieces in the good and better price categories. Its diversified product selection, including traditional, colonial, contemporary and country product lines, is designed to appeal to a wide consumer base.

The company's product strategy is to be a style leader while maintaining the quality and value associated with the Broyhill brand name. That approach grew out of a strategic decision some years ago to transform the company from a manufacturer of basic,

A young couple with small children *furnishing a home for the first time looks for casual style and value — quality furniture at a good price. Furniture Brands International offers a broad range of products that meet both those needs.*

Snuggler, an innovative product by Lane's Action division, is a comfortable chair by day, a twin-sized bed by night.



Broyhill's Hues upholstery and Candlewood occasional furniture create a family room of sheer comfort and excellent styling.

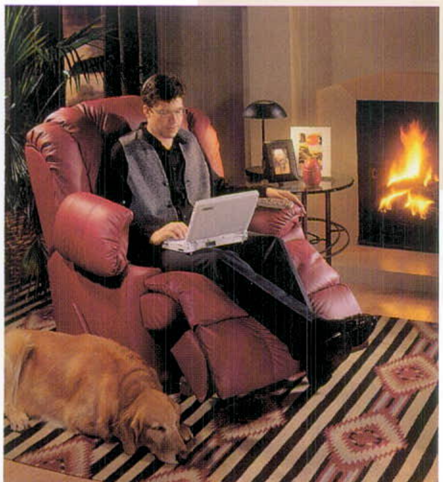
This beautifully balanced, casual contemporary designed bedroom dresser is part of Thomasville's Bridges collection.

Broyhill's Fontana collection, offers flexibility, function and style, and is a top seller.

Newberry II, one of the Broyhill Adaptables youth bedroom collections, is designed to grow as a family grows.

The Lane cedar chest remains one of the most requested gift items in the furniture industry.

The Martinique sleigh bed by Thomasville offers unpretentious simplicity, authentic French traditional detailing and exceptional value.



Lane's Action division is a pioneer in reclining furniture. This Voyager model features heated massage technology, outlets for a speakerphone and a computer, and a beverage holder.

products

low-margin products to a producer of stylish, in-demand, high-margin furniture lines.

To help determine which new products to bring to market, Broyhill carefully monitors trends in consumer tastes, the home building industry and the home furnishings industry.

In 1997, Broyhill had a number of successful new product introductions and expansions.

• The Torréon collection quickly became the second-highest volume bedroom set in Broyhill's line (behind the industry-leading Fontana collection).

• The Maison Lenoir bedroom and dining room collection, introduced in September, is off to a strong start and we expect the line to be very successful in 1998.

• The Watermark collection of occasional furniture, introduced in April 1997, has already been expanded into a full collection with bedroom, dining room, wall systems and coordinating upholstery.

• The Hues collection, introduced in October 1997, has recorded higher order volume than any previous upholstery product introduction.

• Broyhill's leather program and reclining upholstery product line remain very popular with retailers, reflecting a consumer lifestyle trend toward casual home furnishings.

Broyhill is focused on increasing market share in these two fast-growing market segments.

In early 1998, Broyhill began production of its new Windrift collection, and response to the collection's products in the bedroom, occasional and wall system categories has been so favorable that dining room furniture will be introduced at the April 1998 market. In addition, the company will expand its Hues collection, and add coordinating dining room, occasional furniture and wall systems to the Torréon collection.

Lane Furniture Industries, Inc.

Lane

Lane operates seven divisions that specialize in niche markets, including reclining and motion furniture, 18th century reproductions, wicker and rattan furniture, cedar chests and finely tailored upholstered furniture. The products are sold in the better, best and premium price categories.

Through its largest division, Action Industries, Lane is the largest manufacturer of motion furniture in the country, and the second-largest manufacturer of recliners. Action (which in 1997 began marketing its products under the well-known Lane brand name), focuses on three product categories — recliners, motion furniture and sleep sofas.

Action is a major player in the recliner segment of the industry with a wide range of recliner styles, including the Spoiler, believed to be the nation's best selling and most imitated recliner. Action expands its recliner offerings by updating existing recliner categories, such as high-leg recliners and massage recliners, to keep them fresh and current.

In addition, Action continually introduces innovative new recliners. In 1997, the company introduced ComfortKing, the largest recliner ever built. Engineered for people well over six feet tall and weighing more than 250 pounds, ComfortKing includes the strongest recliner frame and mechanism ever manufactured.

Action also introduced Flexback chairs and ottomans in 1997. The Flexback chairs are designed to look like regular, stationary chairs, but have a mechanism that converts the back into a recliner and an ottoman provides leg and foot support. The Flexback and ComfortKing offerings were very successful and have contributed to Action's substantial sales growth.

The most important news from Lane's other divisions in 1997 was the introduction of the Eddie Bauer

A middle-aged couple with teen-aged children *wants to improve the furniture in their home, not merely replace what they have. They may be looking for a mixture of contemporary and traditional styles in the better category, and they can find it among our products.*

Cotswold Cottage from Broyhill's Highland House division was inspired by the well-used and relaxed furnishings found in the homes of the English countryside.

To celebrate the 35th anniversary of its Collector's Cherry line, Thomasville created a second, lighter color featuring golden brown tones in a satin finish.

Eddie Bauer Lifestyles by Lane represents the collaboration of two of America's most recognized brands. This offering of bedroom, dining, occasional and upholstery styles creates an environment that is timeless, and yet unpretentious.

The perfect home work station begins with the WorkStyles collection of home-office furnishings by Thomasville, offered in cherry or oak.

Broyhill's Torréon collection is inspired by Latin architecture and Tuscan designs, and complements a more relaxed, traditional atmosphere.

Lane's ActionMates provide unprecedented choices, including double reclining sofas and loveseats, console sofas with built-in cupholders, cordless telephone and storage. Coordinating tables offer similar versatility.

products

Lifestyles by Lane collection, Lane's biggest introduction in ten years. Three Lane divisions — Lane Division, Lane Venture and Lane Upholstery — manufacture this extensive new collection. The collection was introduced with bedroom and upholstered furniture. Dining room furniture and a patio collection is to be added in 1998. The Eddie Bauer Lifestyles by Lane collection has been extremely well received by furniture retailers. As a matter of fact, it has been placed with over 600 retailers to date.

Lane Division, the leading manufacturer of cedar chests in the United States, sells its products, which include an extensive case goods and occasional table product line, in the better and best price categories. Pearson, which has manufactured finely tailored upholstered furniture for more than 50 years in the premium price category, last year sent a chair and ottoman to both Camp David and the White House for President Clinton. Hickory Chair, which has crafted fine reproductions of 18th century furniture for more than 80 years, continues to produce the James River collection, based on furnishings from Virginia plantations, and the Mount Vernon collection, featuring reproductions of furniture from George Washington's home. In 1997, Hickory Chair continued to expand its all-leather upholstery collection which was successfully introduced in 1996.

Lane's Venture division also continued to create strong interest in the indoor-outdoor furniture market with newly styled products in its WeatherMaster and Weathercraft product lines.

Thomasville Furniture Industries, Inc.

Thomasville was founded in 1904 and has been growing in stature ever since. Most recently, consumers rated it as the "highest quality" furniture brand. Thomasville prices its broad line of wood and upholstered furniture in the better, best and premium price categories.

Thomasville's wood (case goods) division covers the major style categories: American Traditional/Country, 18th Century, European Traditional and Casual Contemporary. Its Collector's Cherry and Mahogany collections have consistently been among the most successful lines in the industry. The company's upholstery division markets its products in three of the major styles — Traditional, American Traditional/Country and Casual Contemporary, targeting the best and premium price categories. In upholstery, style is determined by both frame style and fabric or leather selection, and Thomasville delivers in both areas. The company offers consumers a selection of more than 90 different frame styles and changes as much as 45 percent of its fabric offerings every 12 months to ensure the latest styles are available to consumers.

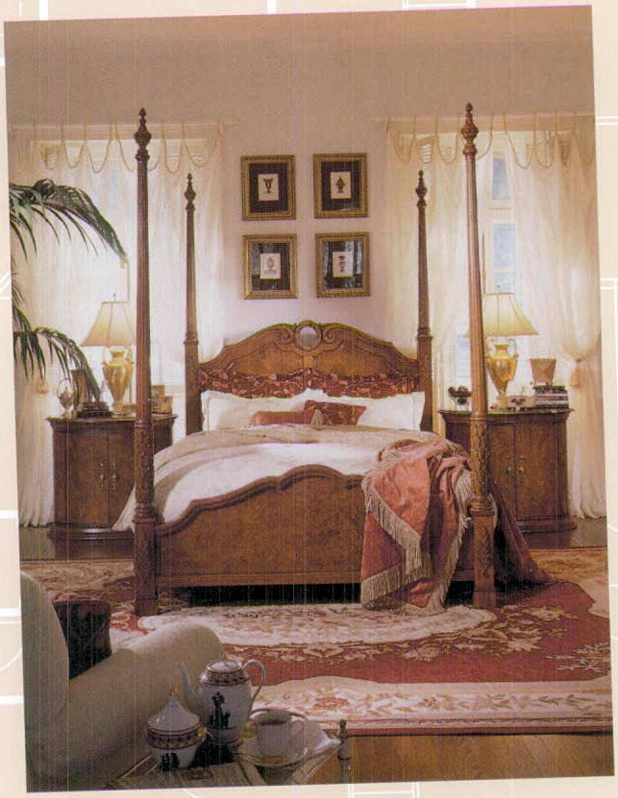
In 1997, Thomasville introduced several new collections, including River Roads, a collection crafted of maple solids, cherry veneers and selected American hardwoods. The company also updated its oldest collection, Collector's Cherry, by giving it a lighter finish to attract those consumers who want a more contemporary look. Another significant collection is Bridges, which includes furniture inspired by the simple, functional style of Shaker designs and produced in a smaller scale for homes where space is at a premium.

Thomasville's primary market has traditionally been more affluent, older consumers who have conservative tastes, but the company is expanding its target to include a younger generation. To that end, the company has recently introduced products which feature smaller scale and lighter wood than Thomasville's traditional wood furniture. Upholstered products now include lighter-colored fabrics which attract today's younger consumers. The price tag will be somewhat lighter as well, falling into the better category, which is attracting a new generation to the Thomasville product line.

An older couple — empty nesters — *is ready to buy fine furniture that can be heirlooms for their children. They are looking for more traditional, elegantly styled furniture in the best category, and Furniture Brands International offers the high-quality products they are looking for.*

Thomasville's Renaissance collection of dining room, bedroom and living room furnishings is inspired by the sun-drenched Mediterranean.

Broyhill's Premier division created this Lindsay Farm cherry collection that reflects a less-formal collaboration of Mission and Shaker styles.



The best-selling Elysée collection by Thomasville, shows the influences of Empire, Louis Philippe and European Traditional designs.

The Manhattan Flexback chair and ottoman, by Lane's Action division, earned Home *magazine's prestigious American Furniture Award for its versatility and beautiful design.*

Broyhill's Hues is a collection of fresh, uncomplicated upholstery frames and fabrics, stylish and color-coordinated.

The Adirondack styling of Chandler Bay, with Lane's Venture division's WeatherMaster protective finish, is ideal for an elegant porch.

Furniture Brands International seeks to drive its valuable brand names through innovative advertising and marketing.

Broyhill, Lane and Thomasville are three of the best known brand names in the residential furniture industry. One of our primary strategies for growth calls for driving our brand names with the customer (i.e., retailer) and, most importantly, with the consumer. To continue building the strength of our brands, we have developed bold, aggressive marketing strategies with an emphasis on advertising.

Last year, we spent record levels on national advertising. In fact, the Company accounts for one-third of the residential furniture industry's total spending on national consumer advertising. Our goal is to increase that percentage and to continue advertising at record levels. In addition to increased spending, we are redirecting where we spend our money. In the past, we focused our advertising expenditures on print ads in shelter magazines such as *Good Housekeeping, House Beautiful* and *Better Homes and Gardens.*

In 1998, we will move to an integrated strategy that will include television advertising, print advertising in shelter magazines and other national print media. The move to television advertising will be new to some of our operating companies, but we believe increased broadcast spending will raise our name recognition, grow sales and position us for continued success.

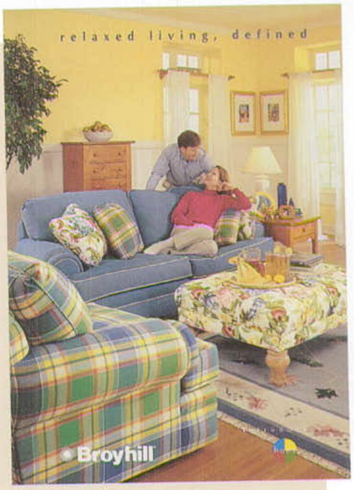
We set ourselves apart from the competition in how we target our advertising. The majority of our competitors make furniture retailers their target audience and spend their advertising dollars in trade magazines. We are one of the few manufacturers to advertise directly to the consumer, and we will continue that strategy — aggressively.

We also reach out directly to consumers through the use of the Internet. Currently, Thomasville and certain of the Lane divisions have web sites on the Internet where pictures and information about our products can be obtained. Once consumers have found the product they want, the sites direct them to the nearest furniture retailers selling that product. Web sites are being developed for all other operating divisions as well as Furniture Brands International.

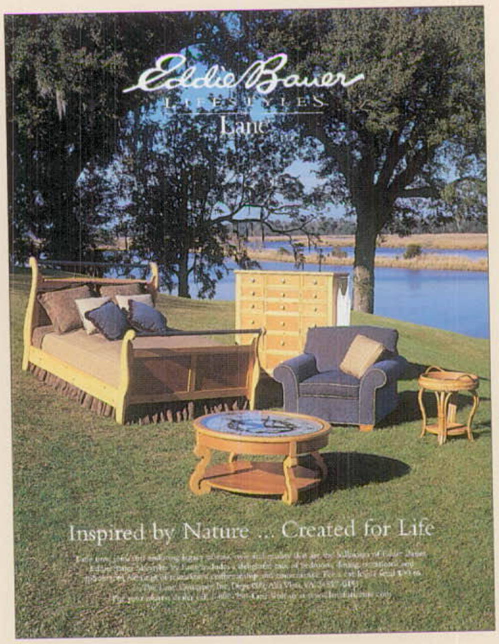
Broyhill Furniture Industries, Inc.

Broyhill's marketing strategy is directed toward becoming the number-one preferred furniture brand in America, while creating consumer demand for Broyhill furniture. This strategy has served the company well as Broyhill has become, based on the results of recent research studies, the most recognized furniture brand in America. The company's advertising and marketing programs — aimed at consumers as well as retailers — continue to create brand awareness among these important audiences and associate Broyhill furniture with a commitment to quality and customer satisfaction.

Placing advertising in popular consumer magazines, not just shelter magazines, is one of Broyhill's key marketing strategies. Four-page inserts in top-ten magazines including *Good Housekeeping, Better Homes and Gardens, Woman's Day* and *Ladies Home Journal* are intended to raise brand awareness for Broyhill and to stimulate demand for the company's products. Broyhill plans to continue



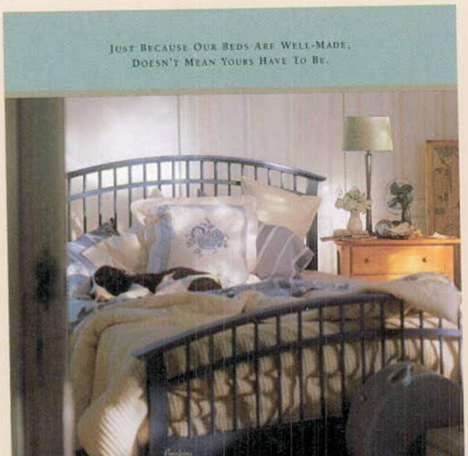
Broyhill combines an excellent print advertising campaign, based on a series of four-page inserts highlighting specific collections, effectively reinforced and complemented by an aggressive effort to obtain regular editorial coverage in numerous home-decorating magazines.



Far left — *Lane's Action division will run a national print campaign featuring its innovative Snuggler in* People, Home *and* Ladies Home Journal.

Left — *Lane has developed a national campaign consisting of print and television advertising to launch the Eddie Bauer Lifestyles by Lane collection this spring.*

Thomasville's new national magazine ads depict a brighter, bolder Thomasville, using a more emotional, creative style that speaks directly to style-conscious young professionals.



From coast to coast, the Broyhill name is recognized as our transport fleet each week moves thousands of pieces of great furniture, any way you look at it.

Broyhill has created attractive point-of-purchase materials, including banners and brochures that support brand identity and provide important information to shoppers.

To a comprehensive marketing program that already includes national print ads, local newspaper inserts and ongoing participation in promotional television game shows, Broyhill will soon add a national TV ad campaign that promises to increase recognition of America's best-known furniture brand.

Lane's Action division is an industry leader in innovative, integrated advertising. Print advertising in national magazines, television ads on networks such as CNN, HGTV, TBS and TNT and point-of-purchase displays at retailers are coordinated to feature the same products. This year, those same products will be displayed on our 50-foot trailers that deliver products to retailers.

The Eddie Bauer Lifestyles by Lane collection debuts in the Eddie Bauer Home stores and catalog in early 1998.

Thomasville is making a major commitment to television advertising with four new TV spots that use humor to illustrate how much consumers love their Thomasville furniture.

Thomasville has developed a complete brand identity and product information system for its retailers designed to create an easy, reassuring atmosphere for consumers.

its program to place company products in magazine editorial features.

Broyhill uses television as part of its extensive branding campaign, in large part by providing furniture as prizes on television game shows such as "Jeopardy!," "The Price is Right" and "Wheel of Fortune." In addition, Broyhill furniture is used on the set of the syndicated "Better Homes and Gardens" television show that reaches approximately 90 percent of the country. In 1998, Broyhill will begin running television commercials in selected markets for the first time as a significant new way of reaching its consumer base.

The company also has an established trade advertising program to reach furniture retailers. The cover of a special trade edition of *Better Homes and Gardens*, distributed to attendees of the October furniture market, featured Broyhill products.

Broyhill is exploring new media with a CD-ROM that includes images of all Broyhill products as well as advertising layouts. Broyhill retailers purchase the CD-ROMs, and can then choose the layout they want as well as the furniture that will be featured in the advertising. The resulting advertisements feature the Broyhill name and the retailer's name — a valuable co-branding technique.

Lane Furniture Industries, Inc.

Lane's marketing approach reflects the diversity of its various divisions. The Action division is now in its third full year of employing an integrated marketing/advertising strategy in which it coordinates magazine, newspaper, circular and cable television advertising with other marketing programs to promote a single product.

For example, in January 1998, Action promoted motion sectional furniture. The company ran an advertisement featuring a particular sectional product in a number of magazines as well as on cable television. In some cases, those impressions were reinforced through radio advertising, point-of-sale promotional materials and even postcards and circulars. In addition, all advertising carries Action's toll-free 800 number and the print advertisements include its World Wide Web address.

Other Lane divisions will be using television advertising for the first time in 1998. Television commercials featuring the Eddie Bauer Lifestyles by Lane collection, produced by the Lane Division, Lane Upholstery and Lane Venture, will run in 1998. These divisions will also advertise the Eddie Bauer product line nationally in a variety of print media.

Other marketing strategies are used by the company to reach the target audiences for their niche products. For example, the Lane Division will continue its Lane Keepsake program, which has made the Lane cedar chest one of the best-known furniture products in the country. Pearson will continue to advertise its finely crafted, elegant upholstered products in *Architectural Digest,* a premium magazine. Hickory Chair has placed its product catalog on a computer disk. The CD-ROMs give sales representatives access to images of all Hickory Chair products without the weight or bulk of photographs and catalogs. For 1998, each of the Lane divisions plan to increase their advertising in national print media.

Thomasville Furniture Industries, Inc.

Thomasville's marketing strategy is to enhance its brand recognition and reinforce consumer perceptions that it is the highest quality residential furniture brand. Thomasville's recent marketing and advertising programs are directed to giving the brand a more contemporary image that will appeal to younger consumers.

Each year, Thomasville has two major retailer promotions, the Winter and Summer Thomasville Sales, using promotional discounts and co-op advertising to reach targeted consumers. As part of these sale events, retailers mail between three and four million magazine-style catalogs, containing 32 to 36 pages, to customers to draw them to Thomasville Galleries and Thomasville Home Furnishings stores. These events have been highly successful marketing promotions for the company.

The company also advertises extensively in the leading shelter and national consumer magazines featuring its various furniture collections.

In 1998, Thomasville plans an expansion of its television advertising program. As many as four new television commercials will be produced and shown throughout the year. The advertisements will be focused on attracting the younger consumer who may not be aware of Thomasville's broad product line and fashionable styling.

Furniture Brands International has the largest distribution network in the industry, and the network is growing.

Furniture Brands International maintains the largest distribution network in the residential furniture industry. The Company breaks down its distribution into three key components: dedicated, nondedicated and strategic alliances.

Dedicated distribution is represented by retailers who have agreed to allocate (i.e., dedicate) a specific amount of their showroom floor space to one of our operating companies' products. Examples of dedicated floor space are Thomasville Home Furnishings Stores (where all floor space is dedicated to the display of Thomasville products), Thomasville, Broyhill or Lane galleries (where a significant portion of a retailer's floor space is dedicated to our products' display) and Broyhill furniture centers and Lane boutiques (smaller versions of the gallery format). Retailers agree to such arrangements because they recognize the importance of our brand names, receive merchandising and sales training assistance and help with advertising and marketing programs.

The Company is aggressively pursuing the expansion of its dedicated space. We are a leader in this distribution area, with twice as much dedicated space as our nearest competitor. At the end of 1997, the Company had approximately 8.6 million square feet (over 1,600 locations) of retailer showroom floor space dedicated to our products — up from 7.6 million square feet at the end of 1996 — a 13 percent increase. We intend to aggressively pursue additional dedicated distribution in 1998.

In addition to dedicated distribution, the Company is pursuing nondedicated distribution with equal vigor. Nondedicated distribution refers to traditional authorized retailers who display our products on their showroom floors, but do not allocate a specific amount of floor space to our brands. The Company's products are displayed in this format in more than 20,000 retail locations. An example is J.C. Penney.

In February 1998, the Company announced a strategic alliance with Haverty Furniture Companies, Inc. under which Havertys will allocate up to 50 percent of its retail floor space to Furniture Brands' products. This alliance represents a new component of the Company's distribution strategy and falls between dedicated and nondedicated distribution. Given the consolidation that is occurring in the retail side of the residential furniture industry, we believe such alliances will be an important part of future distribution practices.

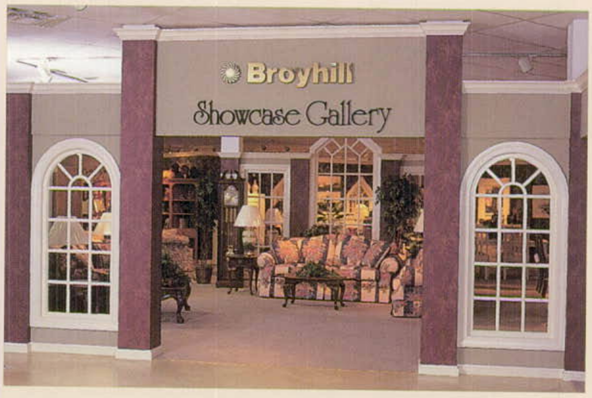
Finally, we want to increase our distribution outside the United States. Today, exports account for approximately 5 percent of our total sales. We expect to grow our international business significantly over the next several years. Our goal is for our export sales to eventually reach 10 percent of our total sales.

Broyhill Furniture Industries, Inc.

Broyhill designed a sophisticated distribution strategy to reach a maximum of retailers and consumers throughout the United States and the world. The strategy includes three distribution channels to accommodate Broyhill customers of all sizes.

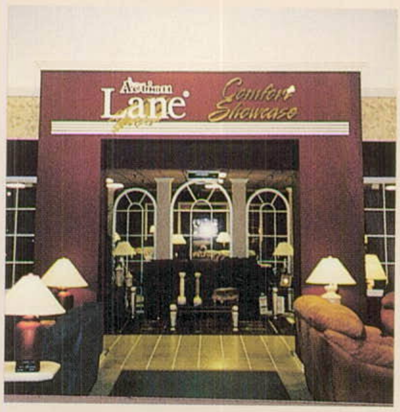
Smaller retailers can take advantage of the Broyhill Furniture Center program, a 2,500-square-foot merchandising concept that is designed to appeal to today's consumers.

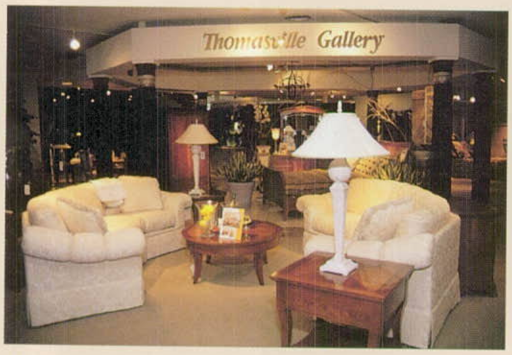
The Broyhill Showcase Gallery program is one of the most popular merchandising programs in the industry. The 348 participating retailers allocate 7,500 square feet of showroom space to Broyhill products in beautiful room settings.



Below — *Almost 100 independent retailers have chosen to open Thomasville Home Furnishings stores that sell only Thomasville products. The stores offer consumers a full selection of Thomasville's quality furniture.*

More than 230 retailers have opened Lane Comfort Showcase galleries, where they devote between 2,500 to 10,000 square feet to Lane's Action division products displayed in room settings.





In a Thomasville Gallery, retailers dedicate at least 7,500 square feet of floor space where they show full-room settings of Thomasville's stylish furniture.

Lane's Hickory Chair division offers a number of gallery programs to encourage retailers to dedicate space to Hickory Chair products.

Furniture Brands International and Havertys have formed an industry-first alliance under which Havertys, the nation's fifth-largest furniture retailer, will allocate up to 50 percent of its floor space to our brands. We, in turn, will increase our service support to Havertys distribution centers.

Furniture Brands International markets its products to all of the national furniture retailers. J.C. Penney represents one of the major players in the industry and is the Company's largest single customer. Our brand names, breadth of product, marketing programs and logistics capabilities are highly compatible with the business practices of national accounts.

Regional furniture retailers are becoming more of a factor in the industry as consolidation accelerates. The retailers shown here, all of whom are major customers of the Company, have leading positions within their individual markets and continue to expand their businesses through internal growth and acquisitions. These larger retailers demand higher service, better product strategies and innovative distribution. Furniture Brands International is one of the few manufacturers that can accommodate all their furniture needs.

The first distribution channel comprises over 6,000 national, regional, and local furniture retailers. Broyhill has long-standing relationships with such powerhouses as J.C. Penney, Sears, Havertys, Breuner's Home Furnishings and Heilig-Meyers, among others. These retailers carry many items in the Broyhill product line, and have the broadest reach among our customer base.

The second distribution channel comprises the Broyhill Showcase Gallery program, which targets medium- to large-size independent furniture retailers. Retailers that participate in the gallery program devote sizable floor space — typically 7,500 square feet — solely to Broyhill products. Membership in the gallery program has numerous benefits for a retailer including: co-op advertising support; showroom design assistance from Broyhill's in-house staff; merchandising support; and occasional exclusive rights to carry certain lines or products. Currently, there are 348 Broyhill Showcase Galleries.

The third distribution channel covers stores in Broyhill's Independent Dealer Program. Retailers participating in this program receive more attractive financing terms than retailers who do not participate. Broyhill's goal is to work with these smaller stores as a partner with a goal of eventually persuading them to open a Broyhill Showcase Gallery. An interim step in this program is the Broyhill Furniture Center — a mini-gallery type distribution approach. At the end of 1997, there were 443 Broyhill Furniture Centers.

Broyhill continues to focus equally on these three key areas of distribution.

Though the distribution strategy has been in place for several years, these channels are not yet mature, and the company will continue to build and nurture relationships with key national, regional and local customers and with prospective customers — by offering them unparalleled service and benefits.

Lane Furniture Industries, Inc.

Lane's seven divisions combined distribute their products to more than 16,000 locations. Products of the Action division are shown on more than one million square feet of dedicated retail space. Since 1995, Action has developed 234 Comfort Showcase Galleries in which an average of approximately 4,200 square feet of retail space is specifically dedicated to the display, promotion and sale of Lane reclining products. The company will continue to expand its gallery program.

Action has heavy penetration among retailers in all industry segments, including independent furniture stores, regional and national chains and department stores.

Lane's other divisions have varying distribution strategies, both dedicated and nondedicated. Dedicated distribution at the end of 1997 included 58 Lane Galleries, 98 Lane Cedar Boutiques, 41 Raymond Waites Galleries and 54 Hickory Chair Galleries. Each division is focusing on increasing its dedicated floor space in 1998.

Thomasville Furniture Industries, Inc.

Thomasville's distribution strategy, unlike the other operating companies, is very focused with less than 700 locations. Thomasville is the only Furniture Brands International operating company that has stores exclusively dedicated to its furniture: Thomasville Home Furnishings Stores. The stores, which average about 15,000 square feet, are owned and operated by independent retailers. At the end of 1997, there were 97 Thomasville Home Furnishings Stores. The company's growth strategy places major emphasis on increasing the number of Thomasville stores over the next several years. In 1998, the company plans to add 25 stores throughout the country and in certain international locations.

Thomasville offers a turnkey operation to a retailer interested in opening a Thomasville Home Furnishings Store. The company will help find the best location for the store, using demographic studies and other research, as well as develop the store site, building plans and store design and layout. These store owners receive additional co-op advertising money, discounts on floor samples, ongoing sales training and other special incentives.

The company's distribution strategy also focuses on galleries and authorized retailers. At the end of 1997, there were 256 Thomasville Galleries, averaging 7,500 square feet, dedicated to Thomasville products, and approximately 330 other authorized retailers nationwide.

Financial Review

Management's Discussion and Analysis of Results of Operations and Financial Condition

General

The following analysis of the results of operations and financial condition of the Company should be read in conjunction with the consolidated financial statements and related notes included elsewhere in this document. In addition, management believes the following factors have had a significant effect on its recent financial statements.

Common stock repurchase

On June 27, 1997, the Company completed the repurchase of 10,842,299 shares of common stock and warrants to purchase 290,821 shares of common stock from Apollo Investment Fund, L.P. and Lion Advisors, L.P. for $170.5 million. The Company financed the repurchase by amending the Secured Credit Agreement to include a new term loan facility of $200.0 million.

Acquisition of Thomasville

During the year ended December 31, 1995, the Company had two primary operating subsidiaries, Broyhill and Lane. On December 29, 1995, the Company acquired Thomasville. The transaction was accounted for as a purchase and, since the acquisition occurred as of the last business day of 1995, was reflected in the Company's consolidated balance sheet as of December 31, 1995. The Company's results of operations for 1995 do not include any of the operations of Thomasville. The cash portion of the acquisition of Thomasville was originally financed through funds obtained by borrowing under the Company's Secured Credit Agreement and the Receivables Securitization Facility. On March 1, 1996, the Company completed a public offering of 10,000,000 shares of common stock, generating net cash proceeds of approximately $81.3 million, which were used to repay a portion of this debt.

1992 Asset Revaluation (Fresh-Start Reporting)

Included in the Company's statements of operations are depreciation and amortization charges related to adjustments of assets and liabilities to fair value made in 1992. These adjustments are a result of the Company's 1992 reorganization and the adoption of AICPA SOP 90-7, "Financial Reporting by Entities in Reorganization under the Bankruptcy Code" (commonly referred to as "fresh-start" reporting) and are not the result of historical capital expenditures.

Management's Discussion and Analysis of Results of Operations and Financial Condition

Results of Operations

As an aid to understanding the Company's results of operations on a comparative basis, the following table has been prepared to set forth certain statements of operations and other data for 1997, 1996 and 1995. The results for 1995 do not include any of the operations of Thomasville.

	Year Ended December 31,					
	1997		1996		1995	
(Dollars in millions)	*Dollars*	*% of Net Sales*	*Dollars*	*% of Net Sales*	*Dollars*	*% of Net Sales*
Net sales	$1,808.3	100.0%	$1,696.8	100.0%	$1,073.9	100.0%
Cost of operations	1,319.5	73.0	1,228.4	72.4	760.4	70.8
Selling, general and administrative expenses	286.1	15.8	283.4	16.7	198.3	18.5
Depreciation and amortization	56.0	3.1	54.1	3.2	36.1	3.3
Earnings from operations	146.7	8.1	130.9	7.7	79.1	7.4
Interest expense	42.7	2.4	45.2	2.7	33.9	3.2
Other income, net:						
Gain on insurance settlement	—	—	—	—	7.9	0.7
Other	3.3	0.2	2.6	0.2	3.9	0.4
Earnings before income tax expense and extraordinary item	107.3	5.9	88.3	5.2	57.0	5.3
Income tax expense	40.2	2.2	34.1	2.0	22.8	2.1
Net earnings before extraordinary item	$ 67.1	3.7%	$ 54.2	3.2%	$ 34.2	3.2%
Gross profit[1]	$ 450.7	24.9%	$ 431.5	25.4%	$ 291.2	27.1%

[1]The Company believes that gross profit provides useful information regarding a company's financial performance. Gross profit has been calculated by subtracting cost of operations and the portion of depreciation associated with cost of goods sold from net sales.

	Year Ended December 31,		
(Dollars in millions)	*1997*	*1996*	*1995*
Net sales	$1,808.3	$1,696.8	$1,073.9
Cost of operations	1,319.5	1,228.4	760.4
Depreciation (associated with cost of goods sold)	38.1	36.9	22.3
Gross profit	$ 450.7	$ 431.5	$ 291.2

Year Ended December 31, 1997 Compared to Year Ended December 31, 1996

Net sales for 1997 were $1,808.3 million compared to $1,696.8 million for 1996, an increase of $111.5 or 6.6%. The improved sales performance for 1997 occurred at each operating company and ranged, in varying degrees, across all product lines. The increase in net sales was achieved through continued introductions of new products, emphasis on the Company's brand names and expansion of distribution.

Cost of operations for 1997 was $1,319.5 million compared to $1,228.4 million for 1996, an increase of 7.4%. Cost of operations as a percentage of net sales increased from 72.4% for 1996 to 73.0% in 1997 primarily due to the negative impact of a manufacturing plant closing and related production realignment at Thomasville.

Selling, general and administrative expenses increased to $286.1 million in 1997 from $283.4 million in 1996, an increase of 0.9%. As a percentage of net sales, selling, general and

Management's Discussion and Analysis of Results of Operations and Financial Condition

administrative expenses decreased from 16.7% for 1996 to 15.8% for 1997 reflecting the Company's ongoing implementation of cost control and reduction programs.

Depreciation and amortization for 1997 was $56.0 million compared to $54.1 million in 1996, an increase of 3.5%. The amount of depreciation and amortization attributable to the "fresh-start" reporting was $16.4 million and $16.3 million in 1997 and 1996, respectively.

Interest expense for 1997 totaled $42.7 million compared with $45.2 million in 1996. The reduced interest expense reflects lower long-term debt balances during the first six months of the year, offset partially by additional long-term debt incurred at the end of the second quarter to finance the Company's repurchase of approximately 10.8 million shares of its common stock.

Other income, net for 1997 totaled $3.3 million compared to $2.6 million for 1996. For 1997, other income consisted of interest on short-term investments of $0.9 million and other miscellaneous income and expense items totaling $2.4 million.

Income tax expense for 1997 totaled $40.2 million, producing an effective tax rate of 37.5% compared with an effective tax rate of 38.6% for 1996. The effective tax rates for both periods were adversely impacted by certain nondeductible expenses incurred and provisions for state and local income taxes.

Net earnings per common share before extraordinary item on a diluted basis were $1.15 and $0.88 for 1997 and 1996, respectively. Weighted average shares outstanding used in the calculation of net earnings per common share on a basic and diluted basis were 56,438,000 and 58,473,000 in 1997, respectively, and 59,172,000 and 61,946,000 in 1996, respectively.

Gross profit for 1997 was $450.7 million compared with $431.5 million in 1996, an increase of 4.5%. The decrease in gross profit margin to 24.9% in 1997 from 25.4% in 1996 was primarily due to the previously noted manufacturing plant closing and related production realignment at Thomasville.

Year Ended December 31, 1996 Compared to Year Ended December 31, 1995

Net sales for 1996 increased to $1,696.8 million from $1,073.9 million in 1995. The improved sales performance resulted primarily from the acquisition of Thomasville. Had Thomasville been acquired at the beginning of 1995, net sales for 1996 would have increased 4.5% over pro forma net sales for 1995. The increase in net sales was achieved through continued introductions of new products and emphasis on the Company's brand names.

Cost of operations for 1996 was $1,228.4 million compared to $760.4 million for 1995. The large increase was the result of the Company's acquisition of Thomasville. Cost of operations as a percentage of net sales increased from 70.8% for 1995 to 72.4% for 1996. This increase was due to the acquisition of Thomasville which had higher cost of operations as a percentage of net sales than the Company's other operating subsidiaries. Had Thomasville been included on a pro forma basis for 1995, cost of operations as a percentage of net sales would have been 73.3%.

Selling, general and administrative expenses increased to $283.4 million for 1996 from $198.3 million in 1995. The large increase was a result of the Company's acquisition of Thomasville. As a percentage of net sales, selling, general and administrative expenses were 16.7% for 1996 compared to 18.5% for 1995 reflecting the Company's acquisition of Thomasville.

Depreciation and amortization for 1996 was $54.1 million compared to $36.1 million in 1995. The large increase was a result of the Company's acquisition of Thomasville. The amount of

Management's Discussion and Analysis of Results of Operations and Financial Condition

depreciation and amortization attributable to the "fresh-start" reporting was $16.3 million and $15.9 million for 1996 and 1995, respectively.

Interest expense for 1996 totaled $45.2 million compared to $33.9 million for 1995. The increase in interest expense reflects additional debt incurred for the acquisition of Thomasville.

Other income, net for 1996 totaled $2.6 million compared to $3.9 million for 1995. For 1996, other income consisted of interest on short-term investments of $1.2 million and other miscellaneous income and expense items totaling $1.4 million.

For 1996, the Company provided for income taxes totaling $34.1 million on earnings before income tax expense and extraordinary item, producing an effective tax rate of 38.6% compared to an effective tax rate for 1995 of 40.0%. The effective tax rates for such periods were adversely impacted by certain nondeductible expenses incurred and provisions for state and local income taxes.

Net earnings per common share before extraordinary item on a diluted basis were $0.88 and $0.67 for 1996 and 1995, respectively. Net earnings per common share before extraordinary item and gain on insurance settlement, net of income tax expense, on a diluted basis was $0.58 for 1995. Weighted average shares outstanding used in the calculation of net earnings per common share on a basic and diluted basis were 59,172,000 and 61,946,000 in 1996, respectively, and 50,114,000 and 50,639,000 in 1995, respectively.

Gross profit for 1996 was $431.5 million, representing an increase of 48.2% over the gross profit of $291.2 million for 1995. The increase resulted primarily from the acquisition of Thomasville. The decrease in gross profit margin to 25.4% for 1996 from 27.1% in 1995 was due to the acquisition of Thomasville which had lower gross profit margins than the Company's other operating subsidiaries. Had Thomasville been included on a pro forma basis in 1995, gross profit margin would have been 24.6%.

Financial Condition and Liquidity

Liquidity

Cash and cash equivalents at December 31, 1997 totaled $12.3 million compared to $19.4 million at December 31, 1996. For 1997, net cash provided by operating activities totaled $103.7 million. Net cash used by investing activities totaled $39.3 million. Net cash used in financing activities totaled $71.5 million, including $173.2 million for the repurchase of common stock and warrants, partially offset by the net addition of $95.2 million of long-term debt and the receipt of $10.7 million from the exercise of warrants and stock options to purchase shares of common stock.

Working capital was $482.3 million at December 31, 1997 compared to $462.7 million at December 31, 1996. The current ratio was 4.5 to 1 at December 31, 1997 compared to 4.2 to 1 at December 31, 1996. The modest increase in working capital between years is primarily the result of the Company's focus on efficient management of individual working capital components.

At December 31, 1997, long-term debt totaled $667.8 million compared to $572.6 million at December 31, 1996. The increase in indebtedness was the result of additional borrowings to finance the repurchase of approximately 11 million shares of common stock and warrants to purchase common stock for $170.5 million, partially offset by repayments of approximately $80 million funded by cash flow from operations and warrant exercise proceeds. The Company's debt-to-capitalization ratio was 67.4% at December 31, 1997 compared to 57.7% at December 31, 1996.

Management's Discussion and Analysis of Results of Operations and Financial Condition

Financing Arrangements

To meet short-term capital and other financial requirements, the Company maintains a $475.0 million revolving credit facility as part of its Secured Credit Agreement with a group of financial institutions. The revolving credit facility allows for both issuance of letters of credit and cash borrowings. Letter of credit outstandings are limited to no more than $60.0 million. Cash borrowings are limited only by the facility's maximum availability less letters of credit outstanding. At December 31, 1997, there were $235.0 million of cash borrowings outstanding under the revolving credit facility and $34.7 million in letters of credit outstanding, leaving an excess of $205.3 million available under the revolving credit facility.

On June 27, 1997, the Company completed the repurchase of 10,842,299 shares of its common stock and warrants to purchase 290,821 shares of common stock from Apollo Investment Fund, L.P. and Lion Advisors, L.P. for approximately $170.5 million. The Company financed the repurchase by amending its Secured Credit Agreement to include a new term loan facility of $200.0 million. The term loan facility is a non-amortizing ten-year facility, bearing interest at a base rate plus 0.75% or at an adjusted Eurodollar rate plus 1.75%, depending upon the type of loan the Company executes. Net cash proceeds received from the term loan facility in excess of the amount required for the stock and warrant repurchase and associated fees and expenses were used to reduce outstanding borrowings from the revolving credit facility under the Company's existing Secured Credit Agreement.

The Company also maintains a Receivables Securitization Facility totaling $225.0 million pursuant to which the Company sells interests in the trade receivables of its operating companies to a third party financial institution. The Company accounts for the Receivables Securitization Facility as long-term debt. The Company's cost of borrowing is based on a commercial paper index rate plus a program fee.

In February 1996, in order to reduce the impact of changes in interest rates on its floating rate long-term debt, the Company entered into three-year interest rate swap agreements having a total notional amount of $300.0 million. The swap agreements effectively convert a portion of the Company's floating rate long-term debt to a fixed rate. The Company pays the counterparties a fixed rate of 5.14% per annum and receives payment based upon the floating three-month Eurodollar rate.

The Company believes its Secured Credit Agreement and the Receivables Securitization Facility, together with cash generated from operations, will be adequate to meet liquidity requirements for the foreseeable future.

Other

The Company has commenced conversion of its computer programs and files in order to function in the year 2000. The Company believes the cost of conversion will not be material to its results of operations and financial position.

Consolidated Balance Sheets

(Dollars in thousands)	December 31, 1997	December 31, 1996
Assets		
Current assets:		
Cash and cash equivalents	$ 12,274	$ 19,365
Receivables, less allowances of $13,793 ($19,124 at December 31, 1996) (Note 6)	293,975	283,417
Inventories (Note 4)	287,046	281,107
Prepaid expenses and other current assets	25,214	23,378
Total current assets	618,509	607,267
Property, plant and equipment:		
Land	16,758	16,292
Buildings and improvements	178,245	172,783
Machinery and equipment	264,689	236,654
	459,692	425,729
Less accumulated depreciation	165,631	123,767
Net property, plant and equipment	294,061	301,962
Intangible assets (Note 5)	330,549	344,101
Other assets	14,117	15,874
	$1,257,236	$1,269,204
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable	$ 52,141	$ 61,095
Accrued employee compensation	29,430	29,864
Accrued interest expense	7,451	6,579
Other accrued expenses	47,199	47,068
Total current liabilities	136,221	144,606
Long-term debt (Note 6)	667,800	572,600
Other long-term liabilities	129,893	132,341
Shareholders' equity:		
Preferred stock, authorized 10,000,000 shares, no par value – issued, none	—	—
Common stock, authorized 100,000,000 shares, $1.00 stated value – issued 52,003,520 and 61,432,181 shares at December 31, 1997 and 1996 (Note 7)	52,003	61,432
Paid-in capital	124,595	278,554
Retained earnings	146,724	79,671
Total shareholders' equity	323,322	419,657
	$1,257,236	$1,269,204

See accompanying notes to consolidated financial statements.

Consolidated Statements of Operations

(Dollars in thousands except per share data)	*Year Ended December 31,* 1997	1996	1995
Net sales	$1,808,276	$1,696,795	$1,073,889
Costs and expenses:			
Cost of operations	1,319,455	1,228,355	760,393
Selling, general and administrative expenses	286,086	283,432	198,321
Depreciation and amortization (includes $16,369, $16,285 and $15,922 related to fair value adjustments)	55,995	54,082	36,104
Earnings from operations	146,740	130,926	79,071
Interest expense	42,747	45,217	33,845
Other income, net:			
Gain on insurance settlement (Note 11)	—	—	7,882
Other	3,261	2,583	3,930
Earnings before income tax expense and extraordinary item	107,254	88,292	57,038
Income tax expense (Note 8)	40,201	34,070	22,815
Net earnings before extraordinary item	67,053	54,222	34,223
Extraordinary item – early extinguishment of debt, net of tax benefit (Note 10)	—	(7,417)	(5,815)
Net earnings	$ 67,053	$ 46,805	$ 28,408
Net earnings per common share – basic (Note 2):			
Net earnings before extraordinary item	$ 1.19	$ 0.92	$ 0.68
Extraordinary item – early extinguishment of debt	—	(0.13)	(0.11)
Net earnings per common share – basic	$ 1.19	$ 0.79	$ 0.57
Net earnings per common share – diluted (Note 2):			
Net earnings before extraordinary item	$ 1.15	$ 0.88	$ 0.67
Extraordinary item – early extinguishment of debt	—	(0.12)	(0.11)
Net earnings per common share – diluted	$ 1.15	$ 0.76	$ 0.56

See accompanying notes to consolidated financial statements.

Consolidated Statements of Cash Flows

(Dollars in thousands)	Year Ended December 31, 1997	1996	1995
Cash flows from operating activities:			
Net earnings	$ 67,053	$ 46,805	$ 28,408
Adjustments to reconcile net earnings to net cash provided by operating activities:			
Net loss on early extinguishment of debt	—	7,417	5,815
Depreciation of property, plant and equipment	43,935	42,022	26,371
Amortization of intangible and other assets	12,060	12,060	9,733
Noncash interest expense	1,297	2,042	2,150
(Increase) decrease in receivables	(10,558)	(7,301)	165
(Increase) decrease in inventories	(5,939)	(11,430)	3,340
Decrease in prepaid expenses and intangible and other assets	3,655	13,695	1,179
Increase (decrease) in accounts payable, accrued interest expense and other accrued expenses	(7,405)	33,710	14,794
Decrease in net deferred tax liabilities	(8,056)	(7,972)	(211)
Increase (decrease) in other long-term liabilities	7,669	(15,628)	246
Net cash provided by operating activities	103,711	115,420	91,990
Cash flows from investing activities:			
Acquisition of business (Note 3)	—	—	(335,438)
Proceeds from the disposal of assets	732	2,766	519
Additions to property, plant and equipment	(40,004)	(40,344)	(35,616)
Net cash used by investing activities	(39,272)	(37,578)	(370,535)
Cash flows from financing activities:			
Payments for debt issuance costs	(3,342)	(4,467)	(14,026)
Additions to long-term debt	220,000	380,000	576,000
Payments of long-term debt	(124,800)	(530,279)	(286,574)
Proceeds from the sale of common stock	—	81,292	—
Proceeds from the issuance of common stock	10,734	9,290	201
Payment for the repurchase and retirement of common stock	(168,056)	—	—
Payments for the repurchase of common stock warrants	(5,187)	(19,961)	(2,789)
Payments for common stock offering expenses of selling shareholders	(879)	(764)	—
Net cash provided (used) by financing activities	(71,530)	(84,889)	272,812
Net decrease in cash and cash equivalents	(7,091)	(7,047)	(5,733)
Cash and cash equivalents at beginning of period	19,365	26,412	32,145
Cash and cash equivalents at end of period	$ 12,274	$ 19,365	$ 26,412
Supplemental Disclosure:			
Cash payments for income taxes, net	$ 40,639	$ 33,126	$ 14,386
Cash payments for interest expense	$ 40,707	$ 37,960	$ 32,010

See accompanying notes to consolidated financial statements.

Consolidated Statements of Shareholders' Equity

(Dollars in thousands)	*Common Stock*	*Paid-In Capital*	*Retained Earnings*	*Total*
Balance December 31, 1994	$50,076	$220,788	$ 4,530	$275,394
Net earnings			28,408	28,408
Common stock activity:				
Stock option exercises (Note 7)	43	153		196
Warrant exercises – 564 shares	1	4		5
Warrant purchases – 1,489,422 shares		(2,789)		(2,789)
Foreign currency translations			(58)	(58)
Balance December 31, 1995	50,120	218,156	32,880	301,156
Net earnings			46,805	46,805
Common stock activity:				
Sale of common stock – 10,000,000 shares	10,000	71,292		81,292
Stock option grants and exercises (Note 7)	85	2,309		2,394
Warrant exercises – 1,227,052 shares	1,227	7,522		8,749
Warrant purchases – 3,578,399 shares		(19,961)		(19,961)
Common stock offering expenses of selling shareholders		(764)		(764)
Foreign currency translations			(14)	(14)
Balance December 31, 1996	61,432	278,554	79,671	419,657
Net earnings			67,053	67,053
Common stock activity:				
Repurchase of common stock – 10,842,299 shares	(10,842)	(157,214)		(168,056)
Stock option exercises (Note 7)	174	1,302		1,476
Warrant exercises – 1,298,498 shares	1,298	7,960		9,258
Warrant purchases – 650,071 shares		(5,187)		(5,187)
Retirement of common stock – 58,824 shares	(59)	59		—
Common stock offering expenses of selling shareholders		(879)		(879)
Balance December 31, 1997	$52,003	$124,595	$146,724	$323,322

See accompanying notes to consolidated financial statements.

Notes to Consolidated Financial Statements

(Dollars in thousands except per share data)

1 The Company

Furniture Brands International, Inc. (referred to herein as the "Company") is a major manufacturer of residential furniture. During the year ended December 31, 1997, the Company had three primary operating subsidiaries: Broyhill Furniture Industries, Inc.; The Lane Company, Incorporated; and Thomasville Furniture Industries, Inc.

Substantially all of the Company's sales are made to unaffiliated furniture retailers. The Company has a diversified customer base with no one customer accounting for 10% or more of consolidated net sales and no particular concentration of credit risk in one economic section. Foreign operations and net sales are not material.

2 Significant Accounting Policies

The significant accounting policies of the Company are set forth below.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reported period. Actual results could differ from those estimates.

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and all its subsidiaries. All material intercompany transactions are eliminated in consolidation. The Company's fiscal year ends on December 31. The operating companies included in the consolidated financial statements report their results of operations as of the Saturday closest to December 31. Accordingly, the results of operations will periodically include a 53-week fiscal year. Fiscal year 1997 includes 53 weeks of operations, while 1996 and 1995 each represented 52-week fiscal years.

Cash and Cash Equivalents

The Company considers all short-term investments with an original maturity of three months or less to be cash equivalents. Short-term investments are recorded at amortized cost, which approximates market.

Inventories

Inventories are stated at the lower of cost (first-in, first-out) or market.

Property, Plant and Equipment

Property, plant and equipment are recorded at cost when acquired. Depreciation is calculated using both accelerated and straight-line methods based on the estimated useful lives of the respective assets, which generally range from 3 to 45 years for buildings and improvements and from 3 to 12 years for machinery and equipment.

Intangible Assets

The excess of cost over net assets acquired in connection with the acquisition of Thomasville totaled $93,110. This intangible asset is being amortized on a straight-line basis over a 40-year period.

The Company emerged from Chapter 11 reorganization effective with the beginning of business on August 3, 1992. In accordance with generally accepted accounting principles, the Company was required to adopt "fresh-start" reporting which included adjusting all assets and

Notes to Consolidated Financial Statements

liabilities to their fair values as of the effective date. The ongoing impact of the adoption of fresh-start reporting is reflected in the financial statements for all years presented.

As a result of adopting fresh-start reporting, the Company recorded reorganization value in excess of amounts allocable to identifiable assets of approximately $146,000. This intangible asset is being amortized on a straight-line basis over a 20-year period.

Also in connection with the adoption of fresh-start reporting, the Company recorded approximately $156,800 in fair value of trademarks and trade names based upon an independent appraisal. Such trademarks and trade names are being amortized on a straight-line basis over a 40-year period.

Long-lived assets are reviewed for impairment whenever events or changes in business circumstances indicate the carrying value of the assets may not be recoverable. Impairment losses are recognized if expected future cash flows of the related assets are less than their carrying values.

Fair Value of Financial Instruments

The Company considers the carrying amounts of cash and cash equivalents, receivables and accounts payable to approximate fair value because of the short maturity of these financial instruments.

Amounts outstanding under long-term debt agreements are considered to be carried on the financial statements at their estimated fair values because they were entered into recently and/or accrue interest at rates which generally fluctuate with interest rate trends.

Interest rate swap agreements used by the Company to fix the interest rate on a portion of its floating rate long-term debt are accounted for on the accrual basis. Amounts to be paid or received under the interest rate swap agreements are recognized in income as adjustments to interest expense. The fair value of the interest rate swap agreements at December 31, 1997 exceed the book value by approximately $2.6 million. The fair value of the interest rate swap agreements is based upon market quotes from the counterparties.

Revenue Recognition

The Company recognizes revenue when finished goods are shipped with appropriate provisions for returns and uncollectible accounts.

Income Taxes

Deferred tax assets and liabilities are recognized for the estimated future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates in effect for the year in which those temporary differences are expected to be recovered or settled. The effect of a change in tax rates on deferred tax assets and liabilities is recognized in income in the period that includes the enactment date.

Net Earnings Per Common Share

Effective December 31, 1997, the Company adopted Statement of Financial Accounting Standards (SFAS) No. 128, "Earnings per Share." SFAS No. 128 requires the presentation of basic and diluted net earnings per common share for 1997 interim and annual periods, and restatement of all prior periods presented. The adoption of SFAS No. 128 did not have a material effect on the consolidated financial statements. Restated interim net earnings per common share information for 1997 and 1996 interim periods is contained in Note 13, "Quarterly Financial Information (Unaudited)."

Notes to Consolidated Financial Statements

Stock-Based Compensation

The Company accounts for stock-based compensation using the intrinsic value method prescribed in Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees." Had compensation expense been determined in accordance with Statement of Financial Accounting Standards No. 123 "Accounting for Stock-Based Compensation," net earnings and net earnings per common share would not materially differ from reported amounts.

Reclassification

Certain 1996 and 1995 amounts have been reclassified to conform to the 1997 presentation.

3 Acquisition of Business

On December 29, 1995, the Company acquired all of the outstanding stock of Thomasville Furniture Industries, Inc. The purchase price totaled $331,200 plus the assumption of $8,000 of long-term debt. The purchase price, including capitalized expenses which approximated $4,200, was paid in cash. The transaction was accounted for as a purchase and, since the acquisition occurred as of the last business day of 1995, was reflected in the Company's consolidated balance sheet as of December 31, 1995. The Company's results of operations for 1995 do not include any of the operations of Thomasville.

4 Inventories

Inventories are summarized as follows:

	December 31, 1997	*December 31, 1996*
Finished products	$118,385	$127,292
Work-in-process	53,536	51,587
Raw materials	115,125	102,228
	$287,046	$281,107

5 Intangible Assets

Intangible assets include the following:

	December 31, 1997	*December 31, 1996*
Intangible assets, at cost:		
Reorganization value in excess of amounts allocable to identifiable assets	$146,063	$146,063
Trademarks and trade names	156,828	156,828
Excess of cost over net assets acquired	93,110	93,110
	396,001	396,001
Less accumulated amortization	65,452	51,900
	$330,549	$344,101

6 Long-Term Debt

Long-term debt consists of the following:

	December 31, 1997	*December 31, 1996*
Secured credit agreement:		
Revolving credit facility	$235,000	$359,000
Term loan facility	200,000	—
Receivables securitization facility	220,000	200,000
Other	12,800	13,600
	$667,800	$572,600

Notes to Consolidated Financial Statements

The following discussion summarizes certain provisions of the long-term debt.

Secured Credit Agreement

The Secured Credit Agreement, amended and restated as of June 27, 1997, consists of a revolving credit facility and a term loan facility. The revolving credit facility is a five-year reducing revolving credit facility with an initial commitment of $475,000. The revolving credit facility allows for issuance of letters of credit and cash borrowings. Letter of credit outstandings are limited to no more than $60,000, with cash borrowings limited only by the facility's maximum availability less letters of credit outstanding.

Under the letter of credit facility, a fee of 0.875% per annum (subject to reduction based upon the Company achieving certain leverage ratios) is assessed for the account of the lenders ratably. A further fee of 0.125% is assessed on stand-by letters of credit representing a facing fee. A customary administrative charge for processing letters of credit is also payable to the relevant issuing bank. Letter of credit fees are payable quarterly in arrears.

Cash borrowings under the revolving credit facility bear interest at a base rate or at an adjusted Eurodollar rate plus an applicable margin which varies, depending upon the type of loan the Company executes. The applicable margin over the base rate and the Eurodollar rate is subject to adjustment based upon achieving certain leverage ratios. At December 31, 1997, all loans outstanding under the revolving credit facility were based on the Eurodollar rate.

At December 31, 1997, there were $235,000 of cash borrowings and $34,681 in letters of credit outstanding under the revolving credit facility, leaving an excess of $205,319 available under the facility.

The revolving credit facility has no mandatory principal payments; however, the commitment is reduced to $400,000 on September 30, 1999 and $300,000 on September 29, 2000, with the remaining commitment maturing on September 15, 2001. In addition, the facility requires principal payments from a portion of the net proceeds realized from (i) the sale, conveyance or other disposition of collateral securing the debt, or (ii) the sale by the Company for its own account of additional subordinated debt and/or shares of its preferred and/or common stock.

On June 27, 1997, the Company amended the Secured Credit Agreement to include a new term loan facility of $200,000. The term loan facility is a non-amortizing ten-year facility, bearing interest at a base rate plus 0.75% or at an adjusted Eurodollar rate plus 1.75%, depending upon the type of loan the Company executes. At December 31, 1997, all loans outstanding under the term loan facility were based on the Eurodollar rate.

The common stock of the Company's principal subsidiaries, substantially all of the Company's cash, working capital (other than trade receivables) and property, plant and equipment, have been pledged or mortgaged as security for the Secured Credit Agreement. The Secured Credit Agreement contains a number of restrictive covenants and events of default, including covenants limiting capital expenditures and incurrence of debt, and requires the Company to achieve certain financial ratios, some of which become more restrictive over time.

Receivables Securitization Facility

The Receivables Securitization Facility is an obligation of the Company which matures on December 29, 2000 and is secured by substantially all of the Company's trade receivables. The facility operates through use of a special purpose subsidiary (Interco Receivables Corp.) which "buys" trade receivables from the operating companies and "sells" interests in same to a third party financial institution, which uses the interests as collateral for borrowings in the commercial paper market to fund the purchases. The Company accounts for this facility as long-term debt.

Notes to Consolidated Financial Statements

The Company pays a commercial paper index rate on all funds received (outstanding) on the facility. In addition, a program fee of 0.55% per annum on the entire $225,000 facility is payable on a monthly basis. The balance outstanding at December 31, 1997 was $220,000. The Company may increase or decrease its use of the facility on a monthly basis subject to the availability of sufficient trade receivables and the facility's maximum amount ($225,000).

Other

Other long-term debt consists of various industrial revenue bonds with interest rates ranging from approximately 4.0% to 9.0%. Mandatory principal payments are required through 2004.

Interest Rate Swap Agreements

In February 1996, the Company entered into interest rate swap agreements with two financial institutions to reduce the impact of changes in interest rates on its floating rate long-term debt. The two agreements, which mature in February 1999, have a total notional principal amount of $300,000. The swap agreements effectively convert a portion of the Company's floating rate long-term debt to a fixed rate. The Company pays the counterparties a fixed rate of 5.14% per annum and receives payments based upon the floating three-month Eurodollar rate. The Company is exposed to credit loss in the event of nonperformance by the counterparties; however, the Company does not anticipate nonperformance by the counterparties.

Other Information

Maturities of long-term debt are $0, $0, $220,000, $235,000 and $0 for years 1998 through 2002, respectively.

7 Common Stock

The Company's restated certificate of incorporation includes authorization to issue up to 100.0 million shares of common stock with a $1.00 per share stated value. As of December 31, 1997, 52,003,520 shares of common stock were issued and outstanding. It is not presently anticipated that dividends will be paid on common stock in the foreseeable future and certain of the debt instruments to which the Company is a party restrict the payment of dividends.

Shares of common stock were reserved for the following purposes at December 31, 1997:

	Number of Shares
Common stock options:	
Granted	3,897,930
Available for grant	972,306
	4,870,236

Under the Company's 1992 Stock Option Plan, certain key employees may be granted nonqualified options, incentive options or combinations thereof. Nonqualified and incentive options may be granted to expire up to ten years after the date of grant. Options granted become exercisable at varying dates depending upon the achievement of certain performance targets and/or the passage of certain time periods.

The 1992 Stock Option Plan authorizes grants of options to purchase common shares at less than fair market value on the date of grant. During 1996, option grants totaling 217,978 common shares were made by the Company at less than market value. These options were issued to Thomasville employees as compensation for forfeited deferred compensation plans due to the acquisition; therefore, the cost of issuing the options at less than market value was included in determining the excess of cost over net assets acquired.

Notes to Consolidated Financial Statements

Changes in options granted and outstanding are summarized as follows:

	Year Ended December 31,					
	1997		1996		1995	
	Shares	Average Price	Shares	Average Price	Shares	Average Price
Beginning of period	3,859,476	$ 6.63	2,498,000	$4.75	2,643,000	$4.64
Granted	292,500	16.36	1,620,926	9.14	125,000	6.42
Exercised	(173,964)	3.93	(85,050)	3.99	(43,000)	3.38
Cancelled	(80,082)	6.62	(174,400)	4.29	(227,000)	4.68
End of period	3,897,930	$ 7.48	3,859,476	$6.63	2,498,000	$4.75
Exercisable at end of period	1,979,287		1,473,600		1,346,750	
Weighted average fair value of options granted		$ 7.54		$4.79		$2.94

The weighted average fair value of options granted is estimated on the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions: risk free interest rate of 6%; expected dividend yield of 0%; expected life of seven years and expected volatility of 31%.

Summarized information regarding stock options outstanding and exercisable at December 31, 1997 follows:

	Outstanding			Exercisable	
Range of Exercise Prices	Shares	Average Contractual Life	Average Price	Shares	Average Price
Up to $10	2,900,430	5.3	$ 5.55	1,838,287	$ 4.70
$10 – $20	942,500	7.7	12.64	141,000	11.75
$20 – $30	55,000	8.6	21.00	—	—
	3,897,930	5.9	$ 7.48	1,979,287	$ 5.20

Effective December 31, 1997, the Company adopted SFAS No. 128, "Earnings per Share." SFAS No. 128 requires a reconciliation of the numerator and denominator of the net earnings per common share calculations for all periods presented. The numerator for basic and diluted net earnings per common share is net earnings for all periods presented. The denominator for basic and diluted net earnings per common share for 1997, 1996 and 1995 follows:

	Year Ended December 31,		
	1997	1996	1995
Weighted average shares used for basic net earnings per common share	56,438,465	59,172,153	50,114,034
Effect of dilutive securities:			
Stock options	1,447,624	1,052,852	524,545
Warrants	587,105	1,721,448	—
Weighted average shares used for diluted net earnings per common share	58,473,194	61,946,453	50,638,579

Excluded from the computation of diluted net earnings per common share were options to purchase 55,000, 250,000 and 43,000 shares at an average price of $21.00, $14.25 and $7.37 per share during 1997, 1996 and 1995, respectively, and warrants to purchase 7,394,249 shares at $7.13 per share during 1995. The securities were excluded from the calculation of diluted earnings per share because the exercise price was greater than the average market price of the common stock.

Notes to Consolidated Financial Statements

At December 31, 1996, the Company had outstanding approximately 2.0 million warrants to purchase common stock at $7.13 per share. The warrants, which included a five-year call protection which expired on August 3, 1997, were redeemed on August 15, 1997.

8 Income Taxes

Income tax expense was comprised of the following:

	Year Ended December 31, 1997	1996	1995
Current:			
Federal	$43,680	$40,870	$20,499
State and local	4,577	4,014	2,527
	48,257	44,884	23,026
Deferred	(8,056)	(10,814)	(211)
	$40,201	$34,070	$22,815

The following table reconciles the differences between the federal corporate statutory rate and the Company's effective income tax rate:

	Year Ended December 31, 1997	1996	1995
Federal corporate statutory rate	35.0%	35.0%	35.0%
State and local income taxes, net of federal tax benefit	2.3	2.3	2.6
Amortization of excess reorganization value	2.4	2.9	4.5
Other	(2.2)	(1.6)	(2.1)
Effective income tax rate	37.5%	38.6%	40.0%

The sources of the tax effects for temporary differences that give rise to the deferred tax assets and liabilities were as follows:

	December 31, 1997	December 31, 1996
Deferred tax assets:		
Expense accruals	$18,855	$14,251
Valuation reserves	8,190	6,514
Employee postretirement benefits other than pensions	3,648	3,318
Inventory costs capitalized	3,367	2,550
Employee pension plans	1,109	—
Other	2,208	1,063
Total gross deferred tax assets	37,377	27,696
Valuation allowance	—	—
Total net deferred tax assets	37,377	27,696
Deferred tax liabilities:		
Fair value adjustments	(76,558)	(77,645)
Depreciation	(5,535)	(7,158)
Fair market value adjustments	(4,631)	—
Employee pension plans	—	(697)
Other	(10,185)	(9,784)
Total deferred tax liabilities	(96,909)	(95,284)
Net deferred tax liabilities	$(59,532)	$(67,588)

Notes to Consolidated Financial Statements

The net deferred tax liabilities are included in the consolidated balance sheet as follows:

	December 31, 1997	December 31, 1996
Prepaid expenses and other current assets	$ 19,214	$ 19,783
Other long-term liabilities	(78,746)	(87,371)
	$(59,532)	$(67,588)

9 Employee Benefits

The Company sponsors or contributes to retirement plans covering substantially all employees. The total cost of all plans for 1997, 1996 and 1995 was $8,412, $9,450 and $7,070, respectively.

Company-Sponsored Defined Benefit Plans

Annual cost for defined benefit plans is determined using the projected unit credit actuarial method. Prior service cost is amortized on a straight-line basis over the average remaining service period of employees expected to receive benefits.

It is the Company's practice to fund pension costs to the extent that such costs are tax deductible and in accordance with ERISA. The assets of the various plans include corporate equities, government securities, corporate debt securities and insurance contracts. The table below summarizes the funded status of the Company-sponsored defined benefit plans.

	December 31, 1997	December 31, 1996
Actuarial present value of benefit obligations:		
Vested benefit obligation	$239,176	$230,456
Accumulated benefit obligation	$246,731	$237,512
Projected benefit obligation	$273,487	$262,667
Plan assets at fair value	306,797	279,054
Plan assets in excess of projected benefit obligation	33,310	16,387
Unrecognized net gain	(33,558)	(13,975)
Unrecognized prior service cost	978	1,021
Prepaid pension cost	$ 730	$ 3,433

Net periodic pension cost for 1997, 1996 and 1995 includes the following components:

	Year Ended December 31, 1997	1996	1995
Service cost-benefits earned during the period	$ 7,120	$ 6,792	$ 3,544
Interest cost on the projected benefit obligation	19,026	18,102	17,005
Actual return on plan assets	(42,531)	(41,006)	(49,272)
Net amortization and deferral	19,628	20,366	31,566
Net periodic pension cost	$ 3,243	$ 4,254	$ 2,843

Employees are covered primarily by noncontributory plans, funded by Company contributions to trust funds, which are held for the sole benefit of employees. Monthly retirement benefits are based upon service and pay with employees becoming vested upon completion of five years of service.

The expected long-term rate of return on plan assets was 8.5% in 1997, 1996 and 1995. Measurement of the projected benefit obligation was based upon a weighted average discount rate of 7.25% and a long-term rate of compensation increase of 4.5% for all years presented.

Notes to Consolidated Financial Statements

Other Retirement Plans and Benefits

In addition to defined benefit plans, the Company makes contributions to defined contribution plans and sponsors employee savings plans. The cost of these plans is included in the total cost for all plans reflected above.

10 Extraordinary Item — Early Extinguishment of Debt

In conjunction with the September 6, 1996 refinancing of the Secured Credit Agreement, the Company charged to results of operations $7,417, net of tax benefit of $4,469, representing the deferred financing fees and expenses pertaining to the refinanced facility. The charge was recorded as an extraordinary item.

In conjunction with the December 29, 1995 acquisition of Thomasville, the Company refinanced its Secured Credit Agreement and amended its Receivables Securitization Facility. As a result thereof, the Company charged to results of operations $5,815, net of tax benefit of $3,478, representing the deferred financing fees and expenses pertaining to such credit facilities. The charge was recorded as an extraordinary item.

11 Gain on Insurance Settlement

On November 20, 1994, an explosion and fire destroyed a particleboard plant owned and operated by the Company. During 1995, the Company rebuilt the plant with proceeds received from the insurance settlement. As a result thereof, a gain on insurance settlement totaling $7,882 was recorded during the fourth quarter of 1995. The gain includes all costs associated with the claim with no further expenses or liability anticipated.

12 Commitments and Contingent Liabilities

Certain of the Company's real properties and equipment are operated under lease agreements. Rental expense under operating leases totaled $15,699, $14,758 and $12,241 for 1997, 1996 and 1995, respectively. Annual minimum payments under operating leases are $11,929, $9,195, $5,925, $2,596 and $797 for 1998 through 2002, respectively.

Prior to the distribution of the common stock of The Florsheim Shoe Company (a former subsidiary) to its shareholders on November 17, 1994, the Company had guaranteed certain of Florsheim's retail store operating leases. At December 31, 1997, the Company had guarantees outstanding on 71 retail store leases with a contingent liability totaling approximately $24,132. The Florsheim Shoe Company has agreed to indemnify the Company against any losses incurred as a result of the lease guarantees.

The Company is or may become a defendant in a number of pending or threatened legal proceedings in the ordinary course of business. In the opinion of management, the ultimate liability, if any, of the Company from all such proceedings will not have a material adverse effect upon the consolidated financial position or results of operations of the Company and its subsidiaries.

Notes to Consolidated Financial Statements

13 Quarterly Financial Information (Unaudited)

Following is a summary of unaudited quarterly information:

	Fourth Quarter	*Third Quarter*	*Second Quarter*	*First Quarter*
Year ended December 31, 1997:				
Net sales	$473,597	$440,666	$444,152	$449,861
Gross profit	116,738	107,803	112,724	113,425
Net earnings	$ 18,865	$ 14,614	$ 16,515	$ 17,059
Net earnings per common share:				
Basic	$ 0.36	$ 0.28	$ 0.27	$ 0.28
Diluted	$ 0.35	$ 0.27	$ 0.26	$ 0.27
Common stock price range:				
High	$ 21 1/8	$ 21	$ 19 3/8	$ 15 7/8
Low	$ 15 7/8	$ 17 1/2	$ 14 3/8	$ 13 7/8
Year ended December 31, 1996:				
Net sales	$434,185	$417,921	$420,742	$423,947
Gross profit	110,627	107,067	108,446	105,333
Net earnings:				
Before extraordinary item	17,429	14,325	11,621	10,847
Extraordinary item	—	(7,417)	—	—
Total	$ 17,429	$ 6,908	$ 11,621	$ 10,847
Net earnings per common share — basic:				
Before extraordinary item	$ 0.28	$ 0.23	$ 0.19	$ 0.20
Extraordinary item	—	(0.12)	—	—
Total	$ 0.28	$ 0.11	$ 0.19	$ 0.20
Net earnings per common share — diluted:				
Before extraordinary item	$ 0.27	$ 0.22	$ 0.18	$ 0.19
Extraordinary item	—	(0.11)	—	—
Total	$ 0.27	$ 0.11	$ 0.18	$ 0.19
Common stock price range:				
High	$ 14 7/8	$ 14 5/8	$ 12 1/8	$ 10 1/8
Low	$ 12	$ 10	$ 9 1/8	$ 8 3/8

The Company has not paid cash dividends on its common stock during the three years ended December 31, 1997. The closing market price of the Company's common stock on December 31, 1997 was $20.50 per share.

Independent Auditors' Report

The Board of Directors and Shareholders
Furniture Brands International, Inc.:

We have audited the accompanying consolidated balance sheets of Furniture Brands International, Inc. and subsidiaries as of December 31, 1997 and 1996, and the related consolidated statements of operations, shareholders' equity, and cash flows for each of the years in the three-year period ended December 31, 1997. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Furniture Brands International, Inc. and subsidiaries as of December 31, 1997 and 1996, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 1997, in conformity with generally accepted accounting principles.

KPMG Peat Marwick LLP

St. Louis, Missouri
January 29, 1998

Five-Year Consolidated Financial Review

(Dollars in thousands except per share data)	Year Ended December 31,				
	1997	1996	1995	1994	1993
Summary of operations:					
Net sales	$1,808,276	$1,696,795	$1,073,889	$1,072,696	$980,532
Gross profit	450,690	431,473	291,237	298,712	275,323
Interest expense	42,747	45,217	33,845	37,886	38,621
Earnings before income tax expense, discontinued operations and extraordinary item	107,254	88,292	57,038	48,841	37,266
Income tax expense	40,201	34,070	22,815	20,908	15,924
Net earnings from continuing operations	67,053	54,222	34,223[1]	27,933	21,342
Discontinued operations	—	—	—	10,339	24,026
Extraordinary item	—	(7,417)	(5,815)	—	—
Net earnings	$ 67,053	$ 46,805	$ 28,408	$ 38,272	$ 45,368
Per share of common stock – diluted:					
Net earnings from continuing operations	$ 1.15	$ 0.88	$ 0.67[1]	$ 0.54	$ 0.41
Discontinued operations	—	—	—	0.20	0.47
Extraordinary item	—	(0.12)	(0.11)	—	—
Net earnings	$ 1.15	$ 0.76	$ 0.56	$ 0.74	$ 0.88
Weighted average common and common equivalent shares outstanding – diluted (in thousands)	58,473	61,946	50,639	51,495	51,375
Other information (continuing operations):					
Working capital	$ 482,288	$ 462,661	$ 455,036	$ 308,323	$271,588
Property, plant and equipment, net	294,061	301,962	306,406	181,393	191,581
Capital expenditures	40,004	40,344	35,616	21,108	30,197
Total assets	1,257,236	1,269,204	1,291,739	881,735	858,163
Long-term debt	667,800	572,600	705,040	409,679	403,255
Shareholders' equity	$ 323,322	$ 419,657	$ 301,156	$ 275,394	$338,557

[1]Net earnings from continuing operations before gain on insurance settlement, net of income tax expense, and net earnings per common share from continuing operations before gain on insurance settlement, net of income tax expense, were $29,463 and $0.58, respectively.

Board of Directors

KATHERINE BUTTON BELL [2]
President of Button Brand Development, Inc.

WILBERT G. HOLLIMAN [1*]
President and Chief Executive Officer of the Company

BRUCE A. KARSH [2,3]
President of Oaktree Capital Management, LLC

BRENT B. KINCAID
President and Chief Executive Officer of Broyhill Furniture Industries, Inc.

DONALD E. LASATER [2,3*]
Retired Chairman of the Board and Chief Executive Officer of Mercantile Bancorporation Inc.

LEE M. LIBERMAN [2*]
Retired Chairman of the Board and Chief Executive Officer of Laclede Gas Company

RICHARD B. LOYND [1]
Chairman of the Board of the Company

ALBERT E. SUTER [1,3]
Senior Vice Chairman of Emerson Electric Co.

COMMITTEES OF THE BOARD

[1] Executive Committee
[2] Audit Committee
[3] Executive Compensation and Stock Option Committee
*(*indicates Committee Chairman)*

Principal Corporate Officers

RICHARD B. LOYND
Chairman of the Board

WILBERT G. HOLLIMAN
President and Chief Executive Officer

DAVID P. HOWARD
Vice-President, Treasurer and Chief Financial Officer

LYNN CHIPPERFIELD
Vice-President, General Counsel and Secretary

STEVEN W. ALSTADT
Controller and Chief Accounting Officer

Presidents of Operating Companies

BRENT B. KINCAID
Broyhill Furniture Industries, Inc.

JOHN T. FOY*
Lane Furniture Industries, Inc.

CHRISTIAN J. PFAFF
Thomasville Furniture Industries, Inc.

(*President of Action Industries, Inc.)

Investor Information

TRANSFER AGENT AND REGISTRAR FOR COMMON STOCK
The Bank of New York
Church Street Station
New York, New York 10286
(800) 524-4458

EXCHANGE LISTING
Common shares are listed on the New York Stock Exchange (trading symbol: FBN).

CORPORATE OFFICES
101 South Hanley Road
St. Louis, Missouri 63105-3493
(314) 863-1100

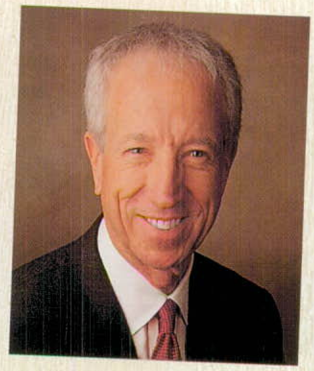
ANNUAL MEETING
The Annual Meeting of Shareholders will be at 10:00 a.m. on Wednesday, May 6, 1998, at the Ritz-Carlton Hotel, 100 Carondelet Plaza, St. Louis, Missouri.

FORM 10-K ANNUAL REPORT
Shareholders may obtain a copy of the current Form 10-K filed with the Securities and Exchange Commission by writing to the Treasurer of Furniture Brands International at the Corporate Offices.

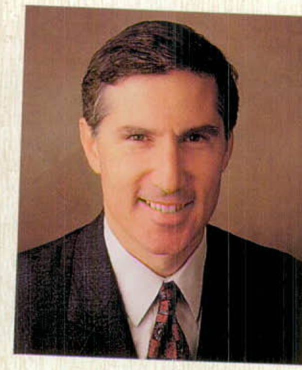
INDEPENDENT AUDITORS
KPMG Peat Marwick LLP
10 S. Broadway
St. Louis, Missouri 63102-1761
(314) 444-1400

Board of Directors

Katherine Button Bell



Wilbert G. Holliman

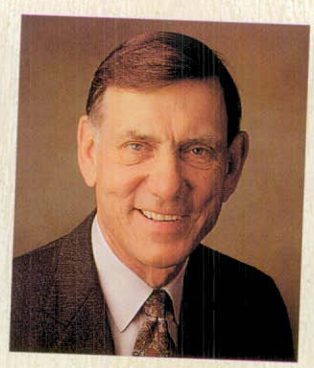


Bruce A. Karsh

Brent B. Kincaid

Donald E. Lasater

Lee M. Liberman



Richard B. Loynd

Albert E. Suter

Furniture Brands
INTERNATIONAL

St. Louis, Missouri